

INFLATION, INFLATION, LESS INFLATION

The Good News

The most recent inflation data was released on Wednesday, August 10th. The good news from this data is that headline inflation as measured by the Consumer Price Index (CPI) came in slightly lower than expected at a year-over-year rate of 8.5%. This suggests that inflation has slowed and, for the first time in months, a new 40-year high was not established.

More detailed parsing of the data includes other good news. Month-over-month CPI for July was at 0.0%. Core CPI, which excludes food and energy due to their more volatile price swings, experienced a month-over-month increase of only 0.3%, down from June's 0.7% increase. The Producer Price Index (PPI), which reflects the supply conditions of our economy, tells a similar story. On a year-over-year rate, PPI rose by 9.8% compared to June's year-over-year increase of 11.3%.

The Bad News

While the most recent data is positive and may be the start of the inflation slowdown the US economy has been waiting for, there is still reason to be concerned. The price of food, and in particular groceries, rose significantly in July. Rents are soaring across the nation as rising mortgage rates keep would-be home buyers in the rental market. In general, inflationary measures are still too high for a sustainable economy.

The Fed

These conditions are keeping the Federal Reserve (the Fed) active as it raises short term interest rates and continues its quantitative tightening strategy by selling off its balance sheet. In fact, many experts, including members of the Federal Open Markets Committee, are relatively unfazed by the positive CPI news and would like the Fed to remain aggressive in its fight against inflation. Federal Reserve Governor, Michelle Bowman, stated that she would like to see future rate hikes at a similar level to the two recent hikes of 0.75% "until we see inflation declining in a consistent, meaningful, and lasting way." Viewpoints like Bowman's suggests that higher interest rates are still to come.

Impact of Inflation on Rates

Nonetheless, some have argued that inflation, and bond yields along with it, have peaked. The 10-Year US Treasury (UST) peaked year-to-date in mid-June at 3.49%. Since then, the 10-Year UST reached as low as 2.60% on August 1st and was most recently at 2.78% as of August 10th.

Impact of Inflation on Municipal Bond Market

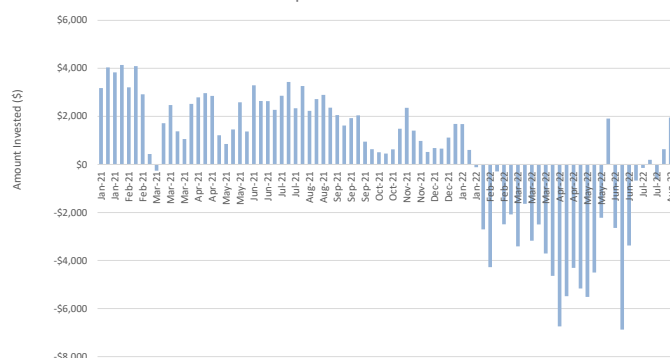
The municipal bond market has followed a similar trend. The 20-Year Municipal Market Data (MMD) rate reached a year-to-date high in mid-June at 3.24%. As of August 10th, the 20-Year MMD rate is 2.77%. The graph below shows how the MMD has moved since January 2020.

MMD Bond Index January 2020 - Current



The recent downward movement in interest rates is tied to the flow of funds data across the same time frame. While this calendar year has seen negative fund flows in all but three weeks through the end of June, there have been three positive weeks of fund flows over the past four weeks alone, according to the Investment Company Institute (ICI). The most recent data, for the week ending August 3rd, recorded \$1.95 billion in positive fund flows, the highest amount in any week year-to-date. Please see the graph below for weekly fund flow data since January 2021.

Municipal Bond Fund Flows



As the economy progresses into the second half of the year, economists will be looking to see if the Fed's activity might result in a recession. The Fed is hoping for a soft landing, but if this does not happen, the Fed could be compelled to enter another round of quantitative easing by cutting short-term interest rates. As significant changes in the municipal bond market take place, PMA remains committed to communicating these developments to our public sector partners. In the meantime, if you have any questions about your bond issue or the bond market in general, please reach out to a PMA advisor below.



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